

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Migden Analyst: LuAnna Hass Bill Number: AB 25

Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: 12/4/2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exclusion/Employer-Provided Medical Insurance Benefits/Includes Domestic Partners

SUMMARY

This bill would allow several existing taxpayer benefits for medical expenses and health insurance benefits to include a taxpayer's domestic partner and a domestic partner's dependents.

This bill also would make changes to a variety of state laws regarding domestic partners. These proposed changes do not affect the department and are not discussed in this analysis.

EFFECTIVE DATE

This bill would be effective January 1, 2002, and operative for taxable years beginning on or after that date.

LEGISLATIVE HISTORY

AB 901 (1999), an identical bill as amended on April 12, 1999, failed passage in the Assembly Appropriations Committee.

SPECIFIC FINDINGS

Under **federal and state law**, a taxpayer may deduct as an itemized deduction those medical expenses that are not reimbursed by insurance or otherwise, for medical care of the taxpayer, his or her spouse, or a dependent, to the extent that these expenses exceed 7.5% of the taxpayer's adjusted gross income (AGI). Medical expenses include amounts paid for diagnosis, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Medical care also includes the cost of certain travel and lodging to obtain the medical care, accident and health insurance, eligible long-term care insurance, and prescription drugs.

The taxpayer also may deduct the cost of certain capital improvements (e.g., elevators and swimming pools) that exceed the value the improvement added to the property. However, those capital improvements must be recommended by a qualified physician in order to qualify.

Long-term care insurance contracts (LTCIC) qualify as a medical expense if certain conditions are met. Among other required conditions, the LTCIC can only provide long-term care services to chronically ill individuals and those services must be prescribed by a licensed health care practitioner.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

2/5/01

State-maintained long-term care plans have the same requirements as LTCICs except that the state-maintained plan must:

- be established and maintained by a state or instrumentality thereof,
- only provide qualified long-term care services as defined under qualified LTCICs, and
- only provide coverage to an employee or former employee of the state (or any political subdivision or instrumentality thereof) and the spouse or certain dependents of the employee or former employee.

If the state-maintained plan does not meet all of the above requirements (e.g., provides coverage to an individual other than an employee or former employee or spouse or certain dependents of the employee or former employee), the costs of a state-maintained plan would not qualify as a medical expense under federal law.

Federal and state law provides that the gross income of an employee does not include the value of employer-provided accident and health insurance. The employer may deduct the cost of the health insurance coverage for the employee, their spouse, and dependents as an ordinary and necessary business expense.

Further, **current state and federal law** allows self-employed individuals to deduct a certain percentage of the cost of health insurance from gross income in determining AGI. This current deductible percentage is 60%. Under both federal and state law, the deduction from gross income is not allowed if the individual or individual's spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual's spouse. Under both **federal and state law**, the cost of health insurance not deductible as an adjustment to gross income because of the deductible percentage or other limitations may be deducted as an itemized deduction to the extent that it exceeds 7.5% of the taxpayer's AGI.

Federal and state law also provides that gross income does not include amounts attributable to the reimbursement of a medical expense of the taxpayer, spouse or any dependents as long as the medical expense was not deducted in any taxable year.

Under both **federal and state law**, the deduction of medical expenses or the exclusion from gross income discussed above applies to medical care and health insurance provided to the individual taxpayer, the taxpayer's spouse, and their dependents.

State law provides that an employer may offer health insurance benefits to the employees' domestic partner. Because the partner is not considered a spouse for income tax purposes, the cost of providing the insurance to the employee's domestic partner is considered taxable income to the employee.

This bill would provide that the taxpayer's domestic partner be treated as the spouse of the taxpayer for purposes of determining:

- medical expenses deductible as an itemized deduction,
- medical expenses deductible as an adjustment to gross income for self-employed individual health insurance,
- an exclusion from gross income for employer-provided accident and health insurance,
- an exclusion from gross income for medical expense reimbursement if the expense was not previously deducted, and
- long-term health care insurance deductible as a medical expense.

This bill would define the term "domestic partner" by reference to Family Code Section 297. This section states that California recognizes a domestic partnership as being established when specified requirements are met.

Other States

Few states have addressed tax concerns relating to same-sex marriages or domestic partners through legislation. Below are the findings for three states.

Oregon law provides that an employer may offer health insurance benefits to the employees' domestic partner. Because the partner is not a spouse, the cost of providing the insurance to the employee's domestic partner is considered taxable income to the employee. The state allows the taxpayer to make an adjustment on the tax return for this income.

Vermont recently enacted a same-sex civil union law that provides eligible persons of the same sex with an established relationship all the same legal benefits, protections, and responsibilities under law that are granted to spouses in marriage. For state income tax purposes, the parties to a civil union will be taxed in the same manner as married persons.

Hawaii defines domestic partners as reciprocal beneficiaries. Those partners that are legally registered receive some of the same rights and benefits of marriage, including private and public employee prepaid health insurance coverage. State income tax law does not provide reciprocal beneficiaries with income tax benefits such as the exclusion of the value of health insurance coverage from gross income.

Policy Considerations

Neither federal nor state law currently recognizes domestic partners for income tax purposes. This bill would allow several existing taxpayer benefits for medical expenses and health insurance benefits to include a taxpayer's domestic partner and a domestic partner's dependents. This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not impact the department's costs.

Tax Revenue Estimate

This proposal is estimated to impact PIT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning On and After January 1, 2002 Enactment Assumed After June 30, 2001 \$ Millions		
2001-02	2002-03	2003-04
Negligible Loss*	(\$1)	(\$1)

* Loss less than \$50,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this proposal will depend on the amount currently spent by employers to provide health benefits to certain domestic partners and the average marginal tax rate applicable to that amount.

The amount spent by employers to provide health benefits to domestic partners is not known. According to the 1990 U.S. Census data adjusted for overall population growth, there are approximately 495,000 California households headed by a non-senior unmarried couple. If 95% (470,000) of these households have at least one employed person and 75% (352,500) of them have two working people, these households account for approximately 822,500 jobs (2 x 352,500 + 117,500).

Of the 822,500 employed individuals, about 25%, or approximately 205,000, do not have insurance through their employment (the statewide average of workers with employer-provided health insurance is 75% according to the UCLA Center for Health Policy Research). However, given a 75% probability that their working partner does have insurance, about 153,000 working partners without insurance have a partner who has employer-provided insurance. According to legislative background information for AB 901 (1999), 7% of these households are same sex and 93% are opposite sex. This implies that about 11,000 represent same sex households and 142,000 opposite sex households with working partners who have employer-provided insurance. Based on the same source, applying 1% for same sex and 3% for opposite sex households to the above yields an estimated 4,400 working partners (without their own insurance) who are insured through their partners' work-related insurance coverage.

In addition, there are about 117,500 households with non-employed partners who have a working partner (see above). Of those working partners, about 88,000 (75%) of them would be expected to be insured through an employment-related policy. Applying the 1% and 3% coverage rates noted above, there would be about 3,500 additional (non-employed) partners who are insured through their partners' work-related insurance coverage.

The above groups yield a total of about 7,900 households directly affected by this bill (4,400 with two workers and 3,500 with one working partner). For this analysis, this number is rounded to 10,000 for 2001. If employers pay an average of \$1,500 per year for a domestic partner's health policy, employer contributions would amount to \$15 million annually. At an average marginal tax rate of 6.5%, the tax liability equivalent on that \$15 million would amount to \$1 million.

BOARD POSITION

Pending.

Analyst	LuAnna Hass
Telephone #	845-7478
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 25
As Introduced December 4, 2000

AMENDMENT 1

On page 47, strikeout lines 35 and 36 and insert:

means an individual partner in a domestic partnership within the meaning of
Section 297 of the Family Code.